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**SOAH DOCKET NO. 473-08-0334
PUC DOCKET NO. 34800**

**APPLICATION OF ENTERGY GULF §
STATES, INC. FOR APPROVAL §
AUTHORITY TO CHANGE RATES §
AND RECONCILE FUEL COSTS §**

**BEFORE THE STATE OFFICE
OF
ADMINISTRATIVE HEARINGS**



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Public Utility Commission of Texas

ENTERGY GULF STATES' NON-UNANIMOUS SETTLEMENT

TESTIMONY OF

SLADE CUTTER

RATE REGULATION DIVISION

PUBLIC UTILITY COMMISSION OF TEXAS

JUNE 11, 2008

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**ENTERGY GULF STATES' NON-UNANIMOUS SETTLEMENT
TESTIMONY OF SLADE CUTTER**

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I. INTRODUCTION AND PURPOSE OF TESTIMONY

Q. Please state your name and business address.

A. My name is Slade Cutter; my business address is 1701 N. Congress Avenue, Austin, Texas.

Q. Did you file direct testimony as a member of the Staff (Staff) of the Public Utility Commission of Texas (PUC) in this proceeding?

A. Yes. I filed direct testimony in this docket.

Q. What is the purpose of the additional testimony you are now providing?

A. The purpose of this testimony is to evaluate the effects on EGSI's financial condition of the revenue requirement it and certain other intervening parties have proposed in their Non-Unanimous Settlement and to compare it to the revenue requirement proposed by Staff and to EGSI's current revenue requirement.

Q. Do you include any attachments in your testimony?

A. Yes. SC-NUS-1, Pages 1 and 2, is an integral part of my testimony.

Q. What have you concluded based on your analysis of the testimony filed in the NUS?

A. I have concluded that EGSI would retain its financial integrity if its revenue requirement were to be based on Staff's direct case in this docket.

II. FINANCIAL ANALYSIS

Q. Upon what do you base this conclusion?

A. My conclusion is based on: EGSI's forecast of two financial metrics as they would occur over the next five years if EGSI's rates were to be set on the basis of Staff's recommendation, the NUS testimony of EGSI witness Theodore H. Bunting, and the rebuttal testimony of EGSI witness Steven M. Fetter.

Q. What are the two financial metrics you use?

A. One is Funds from Operations Interest Coverage; the other is Funds from Operations to Average Total Debt.

Q. Why did you pick these two ratios?

A. They are the considered the two most important of three metrics¹ that are the only completely objective criteria of which I am aware that indicate a utility's financial health. They are defined by Standard & Poor's (S&P), one of the two largest credit rating agencies in the country, and are widely used by financial experts.

Q. Are these two ratios alone sufficient to determine a utility's financial condition?

A. No. Consideration of these two ratios is very effective because the data of which they are composed addresses historical and current conditions which reflect a utility's ability to meet its financial obligations. However, objective criteria must be supported

¹ The third metric is Total Debt to Total Capital. It is not used here because EGSI witness Bunting did not use it in the discussion of financial indicators in his direct testimony on page 13. This seems reasonable because EGSI's value on this metric is well within the limits of S&P's limits for investment-grade ratings.

1 by the scrutiny of credit experts to insure that phenomena outside the credit metrics
2 will not impinge on credit quality.

3 **Q. How did you analyze EGSI's projected financial condition using the credit**
4 **metrics you have mentioned?**

5 A. Attachment SC-NUS-1 reflects EGSI's confidential response to request for
6 information (RFI) 19-3 from Texas Industrial Energy Consumers (TIEC) in graphical
7 form. EGSI's forecast of its performance on the two metrics mentioned previously is
8 shown. The range that S&P considers indicative of the lowest investment-grade credit
9 rating is also shown.

10 Staff's recommended revenue requirement results in the lowest values of those
11 illustrated for EGSI's performance on both credit metrics. But, more significantly, the
12 graph shows that even under Staff's case EGSI remains well above the values that would
13 indicate a below-investment grade credit rating.

14 **Q. How do the opinions of credit-rating agencies influence your evaluation of**
15 **EGSI's projected financial condition?**

16 A. The opinions of the credit rating agencies take into account qualitative factors as well
17 as the quantitative factors such as the metrics mentioned earlier. Considering both
18 quantitative and qualitative factors, S&P has classified ETI, EGSI's successor and
19 therefore the appropriate entity for assessing future credit quality, as BBB, which is
20 investment grade. It has further classified ETI's rating as having a "negative outlook".
21 S&P attributes this outlook to legal exposure relating to the merchant nuclear
22 generation business of its corporate parent, Entergy Corp. However, S&P concludes,

1 “should Entergy clearly demonstrate that it has no legal exposure to the merchant
2 generation company, despite the existence of the jointly owned services company, the
3 ratings on Entergy and its subsidiaries are likely to be affirmed.”²

4 Moody’s Investors Service, in the same article cited by EGSI witness
5 Fetter³ states, “Moody’s expects to assign a senior secured rating of Baa3 to Entergy
6 Texas if and when the utility issues secured debt, which could occur in early 2008.”⁴
7 Notwithstanding Mr. Fetter’s remarks concerning corporate debt ratings and senior
8 secured debt,⁵ this statement is an indication that ETI’s credit rating may, at ETI’s
9 discretion, be improved.

10 **Q. How does Fitch Ratings rate EGSI?**

11 A. Fitch rates EGSI at below investment grade.

12 **Q. What is your impression of the overall analysis of Messrs. Bunting and Fetter
13 regarding credit quality?**

14 A. It is best summarized by Mr. Bunting in his NUS testimony when he says, “The result
15 in the case will determine whether the Company [EGSI], after a long period of sub-
16 standard equity returns and prolonged weakness in its overall financial condition, can
17 begin the process of improving that condition.”⁶

² Standard & Poor’s, *RatingsDirect, Entergy Texas, Inc.*, February 7, 2008, Page 3.

³ *Rebuttal Testimony of Steven M. Fetter on Behalf of Entergy Gulf States, Inc.*, May 2, 2008, Footnote 1.

⁴ Moody’s Investors Service, *Moody’s Affirms Entergy Gulf States, Assigns Ba1 to EGSI Texas*, December 14, 2007, Page 1.”

⁵ Fetter, Page 8, Line 6 through Page 9, Line 3.

⁶ *Testimony of Theodore H. Bunting, Jr. on Behalf of Entergy Gulf States, Inc. in Support of Non-Unanimous Stipulation*, May 23, 2008, Page 3, Line 21 through Page 4, Line 3.

1 **Q. What is your opinion about the return that equity investors should expect from**
2 **investing in ETI?**

3 A. I believe that Staff's recommended revenue requirement provides the opportunity for
4 ETI to earn a reasonable return for equity investors. I think that the bond rating
5 agencies opinions support my opinion. Although bond holders and equity investors
6 may have competing interests in the event of the liquidation of a firm's assets, on the
7 basis of prospectively evaluating an investment, many of their interests coincide. The
8 credit metrics that I use in my analysis provide a cushion to absorb a shortfall of asset
9 values below the value of outstanding bonds. This cushion also serves as an equity
10 return.

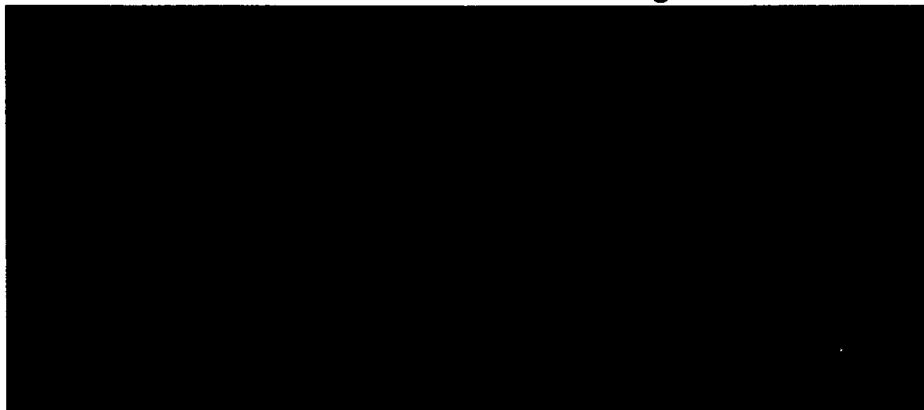
11 **Q. Does this conclude your testimony?**

12 A. Yes.

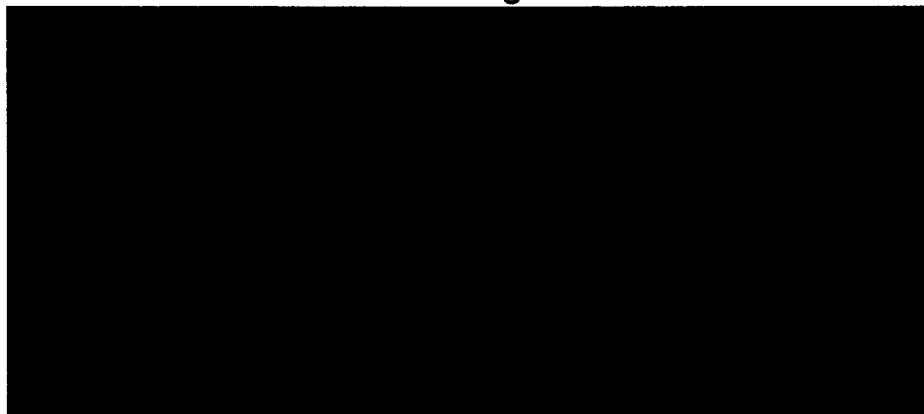
Credit Metrics

CONFIDENTIAL

FFO Interest Coverage



FFO to Average Total Debt



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